

This letter discusses the tax consequences of the gift, or the sale for a nominal value, of a cellular phone as part of a promotional event. See 86 Ill. Adm. 150.305(c). (This is a GIL.)

August 2, 2004

Dear Xxxxx:

This letter is in response to your letter dated August 14, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.ILTAX.com](http://www.ILTAX.com) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This is a request of letter ruling for the following Taxpayer:

NAME

ITEM #1 Taxpayer purchases cellular phones from it's suppliers and since this is a transaction for resale, it pays no sales or use tax on the purchase. If a cellular phone is sold in a transaction that does not involve the customer signing a service contract (unbundled), it typically will be sold at more than it's cost and the appropriate sales tax will be collected. In certain promotional events, and when a customer agrees to enter into a contract with the third-party provider, a cellular phone will be 'given' to the customer for free, or sold at a very nominal price such a \$1.00. (Costs typically exceed \$100 per phone). In most cases, the cellular phone and maybe some accessories will be the only items that appear on the sales invoice.

QUESTION - What should be the basis, if any, for sales or use tax to be charged on the 'free' or nominal charge phone? Please include comments on the taxable nature, if any, of the commission the Taxpayer will get from the third-party as part of your response discussion. In addition, if your response indicates that sales or use taxes from this sale are in fact due, can these taxes be collected from the customer?

ITEM #2 -Taxpayer is only willing to 'give' the phone away to the customer as the result of the commissions it will receive from the third-party service provider. If, by his actions, the customer causes Taxpayer to repay that commission to the service provider, Taxpayer has recourse against the customer to recover that commission directly from the customer in a separate transaction.

QUESTION - Is the commission recovery from the customer subject to sales or use tax? Please consider in your response that the commission recovery can be either more or less than the actual commission that was originally received, but in most cases, no additional revenues are generated from these transactions, it is merely a 'wash.'

### **Department's Response:**

#### **ITEM #1:**

Your letter indicates that in some instances you receive a commission from the third-party cellular service provider for activating a cellular phone for a customer who enters into a service agreement with the third-party provider. The customer receives the phone for free. Based upon the information provided, it appears that you are technically selling the phone to the third-party provider. The third-party provider apparently directs you to give the phone to the customer. The third-party provider in this instance is a "donor". See 86 Ill. Adm. 150.305(c), enclosed. Your "gross receipts" for the sale of the phone consist of whatever portion of the commission from the third-party provider is payment to you for the phone. You should give a Certificate of Resale to your phone supplier when you purchase the phone. When you sell the phone to the third-party provider, you owe Retailers' Occupation Tax and applicable local tax on your gross receipts, and the third-party provider owes the corresponding Use Tax and applicable local tax reimbursements. See 86 Ill. Adm. Code 150.130 (enclosed) concerning Accounting for the Tax, which explains this provision. The customer does not incur a legal obligation to pay any tax under these circumstances. It is important that you keep records of the amount of gross receipts you receive for sale of the phone. If you do not, an auditor will use his best information and judgment to determine the amount of gross receipts.

Your letter indicates that, in other instances, you receive at least some payment from the customer for the cellular phones. If you, as a retailer, sell cellular phones to your customers, then you incur Retailers' Occupation Tax measured by the gross receipts from the sales. At the time you purchase cellular phones from your suppliers, you should supply a Certificate of Resale to the suppliers. Then, when you sell the cellular phones, you will pay Retailers' Occupation Tax based on the amount you receive from your customers. This amount represents the gross receipts received from the sale of the cellular phones. It is important, though, that retailers be very careful when computing the amount of gross receipts from the sales of their cellular phones. "Gross receipts" means "all the consideration actually received by the seller, except traded-in tangible personal property" from all sources. See 86 Ill. Adm. Code 130.401. If the money retailers receive from cellular service providers is the equivalent of a reimbursement for the discount offered to the customer, then this amount is included in gross receipts and is taxable. The retailers are required to collect a complementary Use Tax liability from their customers when the sales of the cellular phones occur. The tax should be listed as a separate item from the selling price of the equipment and not as an administration or service charge. See 86 Ill. Adm. Code 150.135, enclosed. If the commission that retailers receive from cellular service providers represents compensation based on a percentage of an amount agreed to be paid for every activation, it is not subject to sales tax. Please note that this compensation is subject to income tax.

## ITEM #2

Without further information, we will assume that the commission that is repaid to the service provider does not include any part of the gross receipts for the sale of the phone. If, in turn, you have entered into a contractual agreement with the customer allowing you to recover the lost commission, and possibly more, directly from the customer, this arrangement would not be subject to use or occupation tax.

I hope this information is helpful. If you require additional information, please visit our website at [www.ILTAX.com](http://www.ILTAX.com) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Sincerely,

Samuel J. Moore  
Associate Counsel

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